3 T.C. 664 (1944)

Trust income used to pay premiums on life insurance policies covering the grantor is taxable to the grantor, even if the trustee initially obtained the policy after the trust's creation, as long as the trust instrument authorizes such use of income.

Summary

Arthur Stockstrom created a trust for his children, authorizing the trustee to invest in life insurance policies on his own life. The trustee purchased a policy and paid the premiums using the trust's accumulated income. The Tax Court held that the trust income used to pay these premiums was taxable to Stockstrom under Section 167(a)(3) of the Internal Revenue Code. The court reasoned that the legislative intent was to prevent tax avoidance by using trusts to pay for personal expenses like life insurance, regardless of whether the grantor or the trustee initially obtained the policy.

Facts

On December 23, 1936, Arthur Stockstrom established a trust with the Security National Bank Savings & Trust Co. as trustee, designating his four children as beneficiaries. The trust indenture granted the trustee broad authority to invest in various assets, including life insurance policies on Stockstrom's life. The trustee was authorized to use principal or accumulated income to pay the premiums. On December 29, 1936, the trustee applied for a $100,000 life insurance policy on Stockstrom. The policy was issued on December 31, 1936, with the trustee as the owner and beneficiary. During 1939, 1940, and 1941, the trustee paid the annual premiums using the trust's accumulated income.

Procedural History

The Commissioner of Internal Revenue assessed deficiencies against Stockstrom for the tax years 1939, 1940, and 1941, arguing that the trust income used to pay the life insurance premiums should be included in Stockstrom's taxable income. Stockstrom contested the deficiency assessment in the United States Tax Court.

Issue(s)

Whether the income of a trust, used to pay premiums on a life insurance policy on the grantor's life, is taxable to the grantor under Section 167(a)(3) of the Internal Revenue Code, when the trustee, rather than the grantor, initially obtained the policy after the trust's creation, but the trust document authorized purchase of insurance on the grantor's life?

Holding

Yes, because the critical factor is that the trust was used to pay premiums on

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insurance policies on the grantor's life, ultimately benefiting his children, regardless of who initially obtained the policy. The court reasoned that the substance of the transaction aligned with the purpose of Section 167(a)(3), which is to prevent taxpayers from avoiding taxes on income used for their own benefit.

Court's Reasoning

The court emphasized that the purpose of Section 167(a)(3) is to prevent tax avoidance by allocating income through a trust to pay for personal expenses like life insurance premiums. The court stated, "Whether the trust antedated the policies, or the policies antedated the trust, seems as irrelevant in construing the legislative purpose as any question concerning the chronological priority of the egg and the chicken." The court found it irrelevant that the trustee obtained the policy directly rather than Stockstrom assigning an existing policy to the trust. The critical factor was that Stockstrom created the trust, authorized the trustee to purchase life insurance on his life, and the trust income was used for that purpose, ultimately benefiting his children. The court referenced *Burnet v. Wells, 289 U.S. 670 (1933)*, emphasizing the settlor's peace of mind from providing for dependents as a rationale for taxing the trust income to the grantor.

Practical Implications

This case clarifies that the grantor trust rules under Section 167(a)(3) apply even when the trustee initially purchases the life insurance policy, as long as the trust instrument authorizes it and the premiums are paid from trust income. Legal practitioners must advise clients that establishing a trust to purchase life insurance on the grantor, with premiums paid from trust income, will likely result in the trust income being taxed to the grantor. Later cases and IRS rulings have reinforced this principle, focusing on the economic benefit to the grantor and the legislative intent to prevent tax avoidance. The focus is on preventing the circumvention of tax liabilities on personal expenses through the use of trust structures, not merely on the chronological order of policy acquisition and trust creation.

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